STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS

Date Introduced:	**02/23/06**	Bill No:	**SB 1458**
Tax:	**Pseudoephedrine Fee**	Author:	**Simitian**
Related Bills:	**SB 421 (Simitian)**		

This analysis will only address the bill's provisions that impact the Board.

BILL SUMMARY

Among other things, this bill would require the State Board of Equalization (Board) to collect a fee from each person who manufactures pseudoephedrine in this state or who imports pseudoephedrine into this state, based on the number of milligrams of pseudoephedrine manufactured in or imported into this state by that person.

ANALYSIS

Current Law

Under existing Sales and Use Tax Law, all retail sales of tangible personal property are subject to sales tax unless specifically exempted by law. For example, section 6369 of the Revenue and Taxation Code provides that prescription medicines sold or furnished by licensed medical personnel are not subject to tax.

Retail sales of controlled substances are currently subject to sales tax. Unregistered sellers of methamphetamine and other illicit drugs who fail to collect and remit sales tax are in violation of the sales tax law. A number of police departments regularly contact the Board when they make arrests for possession of controlled substances with intent to sell. In order for the Board to levy an assessment, documentation of sales must be available, and assets must be accessible to permit collection of the tax due.

Under Section 11100 of the Health and Safety Code, part of the California Uniform Controlled Substance Act, any manufacturer, wholesaler, retailer, or other person or entity in this state that sells, transfers, or otherwise furnishes pseudoephedrine to any person or entity in this state or any other state is required to submit a report to the Department of Justice (DOJ) of all of those transactions.

Section 11100 of the Health and Safety Code also requires any manufacturer, wholesaler, retailer, or other person or entity in this state to obtain, prior to selling, transferring, or otherwise furnishing pseudoephedrine to any person or business entity in this state or any other state:

- A letter of authorization from that person or business entity that includes the currently valid business license number or federal Drug Enforcement Administration registration number, the address of the business, and a full description of how the substance is to be used, and
- Proper identification from the purchaser.

These reporting requirements do not apply to any sale, transfer, furnishing, or receipt of any product that contains pseudoephedrine which is lawfully sold, transferred, or furnished over the counter without a prescription pursuant to the federal Food, Drug, and Cosmetic Act or regulations adopted thereunder. However, this exclusion does not apply to preparations in solid or liquid dosage form, except pediatric liquid forms, as defined, containing pseudoephedrine, where the individual transaction involves more than three packages or nine grams of pseudoephedrine.

Section 11100 of the Health and Safety Code further provides that it is unlawful for any retail distributor to sell in a single transaction more than three packages of a product that he or she knows to contain pseudoephedrine or to knowingly sell more than nine grams of pseudoephedrine, other than pediatric liquids as defined. Except as otherwise provided, the three-package-per-transaction limitation or nine-gram-per-transaction limitation applies to any product that is lawfully sold, transferred, or furnished over-the-counter without a prescription pursuant to the federal Food, Drug, and Cosmetic Act or regulations adopted thereunder, unless otherwise exempted.

Proposed Law

This bill would add Article 7.3 (commencing with Section 25383) to Chapter 6.8 of Division 20 of the Health and Safety Code to establish the Illegal Drug Lab Waste Cleanup Act. Among other things, this bill would require the Board to collect a fee from persons that manufacture pseudoephedrine in this state or who import pseudoephedrine into this state.

Department of Toxic Substances Control (DTSC)

The DTSC would be required to set the amount of the fee on or before September 1, 2007, and on or before September 1 annually thereafter. The fee would be set at an amount sufficient to fund the annual work plan for taking removal or remedial action to clean up drug lab waste, but in an amount of not more than .0232 cent ($0.000232) per milligram of pseudoephedrine.

This fee would be imposed upon the manufacturing and importation of pseudoephedrine in this state. This bill would require the Board to collect the fee from each registrant on and after September 1, 2007. This is a non-urgency bill and would take effect January 1, 2007. The fee revenues collected would be deposited in the Illegal Drug Lab Cleanup Subaccount, which this bill would create in the Toxic Substances Control Account in the General Fund, for expenditure, upon appropriation by the Legislature, solely for the following purposes:

- To pay for the administrative costs of the Board for collecting and making refunds associated with the collection of the fee imposed.
- To pay for refunds of the fee.
- To provide funding to the DTSC to take removal and remedial actions to clean up drug lab waste.

The DTSC would be allowed to expend the funds authorized for expenditure by entering into a contract with a city or county to take or oversee removal or remedial actions to clean up drug lab waste.

Department of Justice (DOJ)

Under this bill, a person who manufactures pseudoephedrine in this state or who imports pseudoephedrine into this state, would be required to register with the DOJ. The registration requirement would not apply to a person who imports less than an unspecified amount of pseudoephedrine into this state during a calendar year and who does not manufacture any pseudoephedrine in this state. A person would be prohibited from selling or distributing any product containing pseudoephedrine in the state if the product is received or purchased from a manufacturer or importer who is not registered in accordance with the requirements of this bill.

A registrant would be required to file a quarterly report with the DOJ, due on the last day of the month following each quarterly period. All of the following information must be included in the quarterly report:

- The name, address, and telephone number of the person required to register.
- The number of milligrams of pseudoephedrine the person manufactured in this state during that quarterly reporting period.
- The number of milligrams of pseudoephedrine the person imported into this state during that quarterly reporting period.
- The number of milligrams of pseudoephedrine the person sold, transferred, or otherwise furnished to other persons in this state during that quarterly reporting period.
- Any other information the DOJ deems necessary.

The DOJ would be required to maintain the list of registrants electronically, where feasible, and to make the list available to the Board and law enforcement agencies throughout the state where necessary for a legitimate state purpose, including, but not limited to, fee collection and criminal investigation. The DOJ would charge a fee to each registrant sufficient to cover the costs incurred in maintaining the list of registrants, including administrative costs.

Board of Equalization

This bill would require the Board to collect a fee from persons that manufacture pseudoephedrine in this state or who import pseudoephedrine into this state, based upon information contained in a report provided by the DOJ. The report that DOJ provides to the Board would contain all of the following information:

- The name, address, and telephone number of each person required to register with the DOJ, as provided, and who owes a fee in an amount that exceeds an unspecified amount for the previous quarter.
- The number of milligrams of pseudoephedrine the registrant manufactured in this state or imported into this state during the previous quarter.

To collect the fee, the Board would mail each person listed in the DOJ's report a notice of determination (bill). Each notice of determination would contain the amount of the person's fee, as calculated based on the information contained in the DOJ's report. The fee would be calculated by multiplying the established rate by the number of milligrams

of pseudoephedrine manufactured in this state or imported into this state by a manufacturer or importer. The fee imposed would be due and payable 30 days after the Board mails a notice of determination.

The Board would collect the fee in accordance with the Fee Collection Procedures Law (Part 30 (commencing with Section 55001) of Division 2 of the Revenue and Taxation Code). The Fee Collection Procedures Law contains "generic" administrative provisions for the administration and collection of fee programs to be administered by the Board. The Fee Collection Procedures Law was added to the Revenue and Taxation Code to allow bills establishing a new fee to reference this law, thereby reducing the number of sections within the bill required to provide the necessary administrative provisions. Among other things, the Fee Collection Procedures Law includes collection, reporting, refund, and appeals provisions, as well as providing the Board the authority to adopt regulations relating to the administration and enforcement of the Fee Collection Procedures Law. Except for issuing a refund to correct a mathematical error contained in a notice of determination, this bill would prohibit the Board from administering Article 3 (commencing with Section 55081) of Chapter 3 (*Redeterminations*) of, and Article 1 (commencing with Section 55221) of Chapter 5 (*Overpayments and Refunds*) of the Fee Collections Procedures Law. In other words, the Board would not have the authority to accept appeals or claims for refund related to the fees. These matters would be handled by the DOJ.

If the DOJ determines that a person who is required to register has failed to register in accordance with that section or has failed to file a correct quarterly report, the DOJ may register that person, prepare and file a correct quarterly report, and mail a copy of that quarterly report to that person. If a person who receives a quarterly report prepared by the DOJ disagrees with the quarterly report, the person would be required to notify the DOJ and specifically identify the areas of disagreement in writing within 60 days after the date the DOJ mails the quarterly report to the person.

Upon receiving a notice of disagreement, the DOJ would do all of the following:

- Investigate each area of disagreement.
- Mail a responsive letter to the person who submitted the notice of disagreement addressing each area of disagreement.
- Revise the quarterly report as necessary.

Unless the DOJ receives a timely notice of disagreement, the DOJ would forward to the Board the information in the registration and the quarterly report, including a recommendation as to whether the Board should impose a penalty. However, if a timely notice of disagreement is received, the DOJ would, after taking the appropriate actions, forward to the Board the revised information in the registration and the quarterly report and a recommendation to the Board as to whether the Board should impose a penalty. The Board would impose, but not be authorized to relieve, any of the following civil penalties:

- A penalty equal to 10 percent of a person's quarterly fee for each failure of the person to file a correct and timely quarterly report, as required.
- A penalty equal to 25 percent of a person's quarterly fee for each failure by a person to file a correct and timely quarterly report after being notified by the DOJ, as

provided, that the person previously has failed to file a correct and timely quarterly report.

- A penalty equal to 50 percent of a person's fee for each failure to file a correct and timely quarterly report with the intent to evade the fee imposed or to defraud the state.

A registrant may also amend a quarterly report filed with the DOJ any time prior to one year from its due date. If an amendment to a quarterly report would require an increase or decrease in the amount of the fee owed by that person, the DOJ would transmit that information to the Board and direct the Board to issue a supplemental notice to assess the increased amount or to issue a refund for the decreased amount.

Violations

A person who fails to properly register with the DOJ is subject to a civil penalty in an amount not to exceed ten thousand dollars ($10,000). A person who is a retailer or distributor, who receives or purchases a product containing pseudoephedrine intended for sale in the state from a manufacturer or importer who is not registered, is subject to a civil penalty in an amount not to exceed ten thousand dollars ($10,000).

All civil penalties assessed and collected would be deposited into the Environmental Enforcement and Training Account, and the revenues would be available for expenditure pursuant to Title 13 (commencing with Section 14300) of Part 4 of the Penal Code (*Local Environmental Enforcement and Training Programs*).

In General

Methamphetamine, a derivative of amphetamine, is a powerful stimulant that affects the central nervous system. Amphetamines, which were originally intended for use in nasal decongestants and bronchial inhalers and have limited medical applications, including the treatment of narcolepsy, weight control, and attention deficit disorder, can be easily manufactured in clandestine laboratories (meth labs) using ingredients purchased in local stores. Over-the-counter cold medicines containing ephedrine or **pseudoephedrine** and other materials are "cooked" in meth labs to make methamphetamine.

The manufacture of methamphetamine has a severe impact on the environment. The production of one pound of methamphetamine releases poisonous gases into the atmosphere and creates 5 to 7 pounds of toxic waste. Many laboratory operators dump the toxic waste down household drains, in fields and yards, or on rural roads.

Methamphetamine labs can be portable and so are easily dismantled, stored, or moved. This portability helps methamphetamine manufacturers avoid law enforcement authorities. These labs have been found in many different types of locations, including apartments, hotel rooms, rented storage spaces, and trucks.[1]

[1] http://www.whitehousedrugpolicy.gov/publications/factsht/methamph/

Background

In 1997, Senate Bill 560 (Hayden) was introduced to impose a 25% sales and use tax on the retail cash sales of chemicals used as reagents in the manufacturing of methamphetamine. The funds collected would have been used primarily for drug rehabilitation programs. That bill advanced all the way to the Assembly Floor, where it failed to receive the necessary two-thirds votes for passage.

In 1999, a proposal identical to Senate Bill 560 was introduced in Assembly Bill 306 (Corbett). That bill died in the Senate Committee on Appropriations.

This year, Senate Bill 421 (Simitian) was amended to the point that it was almost identical in form to this current bill before it was held in the Senate Appropriations Committee.

COMMENTS

1. **Sponsor and purpose.** This bill is sponsored by the author and is intended to revise the funding mechanism to cleanup drug lab waste. The DTSC has completed emergency cleanups of over 15,000 methamphetamine labs in the past 10 years. The actions involved in the removal are done to protect the public health and safety and the environment from the release, or threatened release, of hazardous substances. The DTSC is responsible for this portion of the cleanup, which is financed by the General Fund.

2. **An appropriation would be necessary to fund administrative start-up costs.** This bill proposes a fee to be collected by the Board, effective January 1, 2007. To assess and collect the fee, the Board would send out notices of determinations (bills) upon receipt of the DOJ report, which is initially due to the Board on May 30, 2007. Therefore, the Board would be sending the notices of determination in June/July 2007. In order to begin to develop the notice of determination forms, hire appropriate staff, and develop computer programs, an adequate appropriation would be required to cover the Board's administrative start-up costs that would not already be identified in the Board's 2006-07 budget.

3. **There are two issues that may make this bill problematic to administer.** First, the language defining "importers" and "manufacturers" in proposed section 25383 should be consistent with the language used to define the persons subject to registration with the DOJ in proposed section 25383.3. This way all "importers" and "manufacturers" would be subject to registration. Second, the fee should not be imposed on the "first manufacturing or importation of pseudoephedrine in this state by a manufacturer or importer, who is required to register pursuant to" proposed section 25383.3, as currently specified in proposed section 25383.1. Instead, the imposition and calculation of the fee should be clarified. The fee should be imposed upon all "importers" and "manufacturers," and apply to each milligram of pseudoephedrine "sold, transferred, or otherwise furnished to other persons in this state." These clarifications will ensure that the reporting requirements in proposed section 25383.4 provide the DOJ and the Board with the information needed to properly calculate the fee, and also remove the need to identify the "first manufacturing or importation" of pseudoephedrine in this state. If the language imposing the fee is not revised as recommended, proposed section 25383.4 should be revised to require "importers" and manufacturers" to report "the first manufacturing or importation of pseudoephedrine in this state." Board staff is

available to work with the author's office in drafting amendments to the bill that would address these issues.

4. **The fee would impact legitimate users.** Assuming that the term "pseudoephedrine" includes nonprescription medicines, such as Sudafed and Sinutab, which contain pseudoephedrine, and assuming that manufacturers and importers increase the selling price of pseudoephedrine products to reimburse themselves for the fee, the proposed fee would fall upon products purchased by legitimate users.

5. **This bill could increase state and local sales and use tax revenues.** In order to be reimbursed for the fee, pseudoephedrine manufacturers and importers may increase the price of pseudoephedrine products, which would be reflected in the retail sales price of pseudoephedrine sold to the ultimate consumer.

   Sales and use tax is due based on the gross receipts or sales price of tangible personal property in this state. Since the proposed pseudoephedrine fee would not be specifically excluded from gross receipts or sales price, it would be included in the amount on which sales or use tax is computed.

6. **Legal challenges of any new fee program might be made on the grounds that the fee is a tax.** In July 1997, the California Supreme Court held in *Sinclair Paint Company v. State Board of Equalization* (1997) 15 Cal.4th 866 that the Childhood Lead Poisoning Prevention Act of 1991 imposed bona fide regulatory fees, not taxes, which would have required a two-thirds vote of the Legislature under Proposition 13. In summary, the Court found that while the Act did not directly regulate by conferring a specific benefit on, or granting a privilege to, those who pay the fee, it nevertheless imposed regulatory fees under the police power by requiring manufacturers and others whose products have exposed children to lead contamination to bear a fair share of the cost of mitigating the adverse health effects of those products.

   The *Sinclair Paint* decision ratified the use of fees approved by a majority of the Legislature to address health or other social problems created by the use or production of a particular product. In order to pass judicial scrutiny, the Court suggests that: 1) A fee must not exceed the cost of providing services related to the remediation of the problem created by a particular product; and 2) A reasonable connection must exist between the social problems remedied by a fee and the payer of the fee.

   Although this measure has been keyed by the Legislative Counsel as a majority vote bill, opponents of this measure might question whether the fees imposed are in legal effect "taxes" required to be enacted by a two-thirds vote of the Legislature.

COST ESTIMATE

The Board would incur non-absorbable costs to develop computer programs, notify feepayers, mailing determinations and processing payments, carrying out compliance activities, training staff, and answering inquiries from the public. A cost estimate of this workload is pending.

REVENUE ESTIMATE

Background, Methodology, and Assumptions

The Bureau of Narcotic Enforcement (BNE) conducted a review of the various distributors and manufacturers that provided pseudoephedrine products to the California retail market during calendar year 2004. Total adult and pediatric consumption of over-the-counter (OTC) products (solid and liquid) was provided in a briefing report titled "2004 Pseudoephedrine OTCs and Methamphetamine Related Issues." For pills and liquid capsules, the actual pills and caps psuedoephedrine consumption data was provided in pounds (lbs). The liquid data was only provided in gallons and, for the purpose of this estimate, had to be converted to pounds.

The report indicated 1.9 billion pills (199,180 lbs of pseudoephedrine) and 209 million liquid caps (16,019 lbs of pseudoephedrine) for adults, totaling 215,199 lbs of pseudoephedrine. Since the liquid data was in gallons (259,336 gallons), we converted gallons to equivalent pounds by extrapolating it from the data provided. We estimated the 259,336 gallons would yield 12,167 lbs of pseudoephedrine. The total quantity of adult pseudoephedrine amounts to 227,336 pounds (215,199 + 12,167). Each pound of pseudoephedrine is equivalent to 453,592 milligrams. Therefore, total pounds converts to 103.1 billion milligrams (227,336 lbs × 453,592 = 103.1 billion milligrams) of adult pseudoephedrine. For pediatrics (solid and liquid), total milligrams was estimated to be 584 million milligrams. Total pseudoephedrine consumption is estimated to be 103.7 billion milligrams (103.1 billion + .584 billion).

Revenue Summary

Based on the proposed maximum fee of $0.000232 per milligram of pseudoephedrine, an estimated $24 million in fee revenues could be generated annually ($0.000232 ×103.7 billion milligrams = $24 million) for deposit in the Illegal Drug Lab Cleanup Subaccount, which this bill would create in the Toxic Substances Control Account in the General Fund.

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